THE JOURNAL

OF

POLITICAL ECONOMY

VOLUME 23 — *October 1915* — NUMBER 8

CANADIAN FINANCIAL PROBLEMS

I. THE FINANCIAL EFFECTS OF WAR AND CHANGES IN ECONOMIC ORGANIZATION

Heretofore, war has frequently necessitated the introduction of novel financial measures: ship money, debasement of the coinage, forced loans, the issue of an irredeemable paper currency, the creation of a permanent debt, the formation of national banks or banking systems, the adoption of the income tax, and the increase of excise and customs duties are a few of the expedients by which governments have tried to defray war expenditures in the past.

Rightly or wrongly, many of these have been discarded. Debasement of the coinage, ship money, forced loans, and other devices of their ilk have long since disappeared from the financial systems of all first-class nations, if, indeed, they have not disappeared in all nations for all time to come. France and the United States have long since redeemed their depreciated paper currencies. Excise duties, imposed to meet such war emergencies as the American Civil, the Spanish-American, and South African wars, have been repealed or reduced to a peace basis.

Other fiscal expedients, after revision, have found a permanent place in the fiscal systems of one or several nations. In Great Britain the income tax, which was introduced during the Napoleonic wars, now provides over 20 per cent of the revenue; there is

little doubt that after the present war its importance will have increased. The Bank of England and the national banking system of the United States are products of war necessities. Customs duties seem to have been particularly popular. It can scarcely be said that France has abandoned the tariff policy she adopted after the Franco-Prussian War. Even more conspicuous is the fact that the fiscal system of the United States, qualified as it was by the tariff revision of 1913, is still based on the post-war tariffs of the sixties and seventies; though there are indications that modifications by the reduction of the tariff and the extension of direct taxation may yet assume great importance in that country. Finally, one may call attention to the fact that in the case of most nations public debts are largely the products of wars.

One must recognize, too, that governmental policies should be, and to a certain extent must be, adapted to the special economic conditions of a country. Once Great Britain had become dependent on other countries for her raw materials, particularly food products, her manufacturers were ready for a radical change in her tariff policy. When customs duties on a few articles provided a large part of the revenue and practically all the revenues from customs duties, manufacturers' demands for the removal of duties on raw materials could be met without a serious disturbance of the fiscal system of the country. Moreover, an increase in expenditures necessitated the development of new forms of taxes, so that today we find that in Great Britain customs duties provide less than 25 per cent of the revenue, compensating excise duties provide almost as large a revenue, and property and income taxes provide a like percentage. The income tax has been particularly successful in England, where, by reason of the development of corporations, the establishment of trust estates, and the increase in foreign investments, a large proportion of investments is taxable at the source.

The effect of economic conditions on fiscal policy is noticeable in the United States. After the Civil War strong opposition was raised against excise duties; they had scarcely a friend and soon disappeared. But customs duties, imposed partly for revenue purposes, partly to compensate for excise duties, and partly for

protection, were retained largely because they had few effective opponents and had many influential friends. The chief exports of the country were agricultural products and the chief imports were manufactures. An extraordinary development of the western states provided such an increase of exportable goods that the United States was soon able to pay a part of the interest on previous borrowings. Contrast with this period another, three decades later, when the United States began to export manufactures and to import certain classes of raw materials and when a new force ranged itself on the side of downward revision of the tariff. As in England, manufacturers, who imported raw materials and exported finished manufactures, altered their opinions on the fiscal question. Incidentally the remarkable growth of the corporate form of organization facilitated the adoption of a federal income tax, which promises to become an increasingly important source of revenue at a time when the percentage of revenue from customs duties has begun the inevitable decline.

There has been much consideration of possible effects of the present war on Canada's revenues. Undoubtedly Canada had already begun and was well on her way toward a readjustment of her economic life when war broke out. The financial effects of the war may carry that readjustment farther than was expected. Whether the two factors we have mentioned—war and changes in economic organization—will necessitate a readjustment so extensive as to advise or require a complete revision of the fiscal system of the Dominion is a subject worth serious consideration.

II. CANADA'S FISCAL SYSTEM

Canada's fiscal system, a child of political expediency, has been reared by a grasping father, the manufacturers, and a subservient mother, the politicians. It has not undergone serious revision since 1879. The "National Policy of Protection," around which it was built, was the chief plank in the Conservative platform in the election of 1878. After Sir John A. Macdonald's election the first National Policy tariff was introduced and passed in 1879. Slight revisions were made from time to time. During the Conservative régime the duties in the iron and steel schedule were

increased in 1887, and Sir George Foster compromised with public opinion by decreasing the duties considerably in 1894. In 1896, the Liberal party, which had just been elected on a platform containing, among other things, the prominent plank, "Tariff for Revenue Only," took into consideration vested interests in Canada and the fact that the Dingley tariff, recently passed in the United States, offered no hope for concessions from that country, and lost their enthusiasm for a "tariff for revenue only." It must be admitted, however, that the Liberal party did introduce the preferential tariff, which it still fathers with a jealous eye, and that the preference accorded to British goods did reduce the scale of protection, especially on those articles in the production of which there was competition between Great Britain, the United States, Canada, and other countries. Commercial treaties and conventions as well as the reduction of the duties on particular articles were the means of other slight reductions of protection during the Liberal régime.

Between 1911, when the Conservative party regained power, and the outbreak of war there had been no important change in the tariff and there was no indication that a downward revision would be made. In fact it was generally expected that the next general revision of the tariff would probably provide Canadian manufacturers with the greatest amount of protection they had ever enjoyed.

One might go so far as to characterize Canada's tariff as "protective and only incidentally for revenue." It would not be difficult to show that many customs duties yield much larger profits to manufacturers than revenues to the Dominion Treasury. Customs duties of about $12\frac{1}{2}$ per cent on imports of provisions amounting to about $12,026,930[1] in the fiscal year 1913 would provide a revenue of about $1,500,000. In the same year Canada exported $27,225,694 of provisions,[2] and, of course, consumed much more than she exported. If the duties increased the price of provisions, as people generally believe, Canadian farmers or produce-dealers must have been more fortunate than the Dominion Treasury.

[1] *Report of Department of Trade and Commerce*, March, 1915, p. 1550.

[2] *Ibid.*, p. 1613.

The same test might be applied to a great many articles of commerce. In 1913 Canada imported $796,291[1] of news print paper subject to a duty of 15 per cent. She exported $5,692,126 and probably consumed much more.[2] In 1912 Canada imported 201,058 tons of pig iron,[3] subject to a duty of $2.50 per ton under the general tariff, while Canadian producers got the benefit of the tariff on an output amounting to 1,014,587 tons.[4] Canada produces over 90 per cent of the steel ingots and billets she consumes, imports of which were charged $2.50 per ton. In the fiscal year 1915 Canada imported but 25,000 tons of steel rails;[5] her productive capacity in 1913 was 506,709 tons or more. Canada produced boots and shoes worth $33,987,248 in 1910;[6] presumably she can produce more today. In 1913 she imported shoes worth only $4,111,492,[7] subject to duties of 25 to 30 per cent. When one takes into consideration the fact that, unlike the United Kingdom, Canada does not impose equivalent excise duties on domestic products, it is obvious that Canadian manufacturers gain more from the tariff than does the Treasury, and that Canada's fiscal system is not designed on the principle of "tariff for revenue only," but that, rather, it is designed for the most part to protect Canadian producers while it provides the Treasury with a comparative pittance of revenue. A customs tariff finds it difficult to serve two masters. What the Canadian tariff yields in the way of revenue depends on the volume of imports; what it yields in the way of protection depends on preventing importation. In the framing of the Canadian tariff the revenue interest has until lately received secondary consideration.

Nevertheless, it must be admitted that Canada depends largely on the tariff for revenue, and that secondary consideration of revenue interests has been adequate to provide very large receipts.

[1] *Ibid.*, p. 1542.

[2] *Ibid.*, p. 1610.

[3] *Mineral Production in Canada*, 1913, p. 108.

[4] *Ibid.*, 1913, p. 91.

[5] *Department of Trade and Commerce*, March 1915, p. 1524.

[6] *Canada Year Book*, 1914, p. 219.

[7] *Report of the Department of Trade and Commerce*, March 1915, p. 1504.

A statement of receipts on Consolidated Fund Account for the fiscal year 1914[1] is as follows:

Customs	$104,691,238.43
Chinese revenue	1,334,791.98
Excise	21,452,036.88
Post-Office	12,954,529.92
Revenue from public works	389,781.69
Revenue from minor public works	32,765.67
Revenue from railways	13,394,317.37
Revenue from canals	380,188.06
Interest on investments	1,964,541.33
Patent fees	252,724.39
Casual	1,505,132.51
Ordinance lands	5,797.98
Fines and forfeitures	322,497.47
Premium, discount, and exchange	187,744.54
Mariners' fund	70,540.52
Electric light inspection	80,441.45
Steamboat inspection	5,421.15
Gas inspection	62,881.90
Weights and measures	111,070.11
Cullers' fees	1,799.40
Law stamps	9,238.75
Penitentiaries	54,313.98
Insurance inspection	41,252.52
Fisheries	99,266.13
Modus vivendi	11,728.50
Canada Gazette	24,152.93
Superannuation	39,817.04
Lighthouse and coast service	751.00
Dominion steamers	28,710.88
Military college	36,816.76
Militia	36,640.77
Civil service examination fees	9,104.00
Supreme and Exchequer Court reports	603.28
Dominion lands	3,036,030.32
Militia pensions revenue	30,713.66
Royal Northwest Mounted Police officers' pensions	4,827.28
Inspection of staples	510,184.01
	$163,174,394.56

[1] *Public Accounts*, 1914, p. 9.

These receipts should of course be considerably reduced if one is to have a proper understanding of Canadian revenues. For instance, the administration of the post-office cost $12,822,058, leaving a net revenue of little over $100,000, and the collection of revenue from railways and canals cost $14,935,138,[1] leaving a deficit on account of public railways and canals. As a matter of fact customs and excise duties provide the funds to pay the deficits of most departments other than customs and inland revenue. These two sources of revenue, and particularly the customs duties, have been assuming increasing importance down until 1913. In 1904 customs receipts amounted to $40,461,591, or 57 per cent, and excise receipts $12,958,708, or 18 per cent, of a total revenue of $52,514,701. In 1913 customs receipts amounted to $111,764,-699, or 66 per cent, and excise receipts, $21,447,445, or 12 per cent, of total revenues of $168,689,903.[2] The year 1914, however, shows returns slightly less favorable for the predominance of customs receipts.

In the United States, $261,274,564, or 38 per cent of the total revenue, was collected from customs duties, and $232,904,119, or 34 per cent, from excise duties in 1904.[3] Since 1909, when the corporation tax law was passed, and 1913, when the customs tariff was reduced and the income tax introduced, the proportion of revenue from internal duties has increased. When war broke out customs duties probably provided twice as large a percentage of revenues in Canada as they provided in the United States and almost three times as large a percentage as they provided in Great Britain.

There is, however, no necessary contradiction between the statement that Canada's tariff is not framed chiefly in the interests of revenue and the statement that customs duties provide about two-thirds of Canada's revenues. In the first place, Canada's customs collections comprise many small items. Boots and shoes provide a revenue of less than $1,000,000. Yet 80 per cent of Canada's consumption is provided at home. Imports of pig iron paid a revenue of less than $500,000. There are a great many items

[1] *Canada Year Book*, 1913, pp. 512–15.

[2] *Ibid.*, p. 510.

[3] *Palgrave's Dictionary*, "Public Finances."

of much less importance, but if one were to add together the long list of small customs collections on particular articles the sum would soon assume very great importance. Had Canada imposed on domestic products of these articles excise duties equal to the customs duties, thus destroying all protection, she would have realized an additional revenue of about $8,000,000 on boots and shoes and $2,500,000 on pig iron. Her customs duties would then have been designed for revenue only.

A second explanation of the importance of Canadian customs receipts lies in the fact that the last decade or more has seen an extraordinary development of Canada's resources. There was a phenomenal extension of the railway net, a wonderful growth of the agricultural area, a great development of manufacturing, and the discovery of new mining areas. Of the many measures of that development none is better than the increase of Canada's imports, and her receipts of customs collections. Dutiable imports increased from $105,969,756 in 1901 to $441,606,885 in 1913.[1] At the same time the ratio of exports to imports fell from 103.19 per cent in 1901 to 75.52 per cent in 1908 and 56 per cent in 1912 and 1913. In other words, Canada was making progress at the expense of heavy borrowings. A favorable balance of trade of $6,000,000 in 1901 was turned into an unfavorable balance of trade of $600,000 in 1902 and $300,000,000 in 1913.[2] In the calendar year 1913 she borrowed $272,935,000 in England and $53,944,000 in the United States. Canada probably spent $350,000,000 on construction work in 1913. But while this expenditure for construction was increasing the government was able to collect huge and increasing revenues on building material borrowed from other countries as well as on increasing volumes of foreign goods for immediate consumption. Without an important revision of the tariff the collections of customs duties increased from $28,293,930 in 1901 to $111,764,699 in 1913.[3]

It would be difficult to prove conclusively that the wonderful growth of Canada's customs receipts was due to the importation of materials for construction purposes. Nevertheless general observations seem to bear out the theory that a great part of the receipts

[1] *Canada Year Book*, 1913, p. 223. [2] *Ibid.*, p. 228. [3] *Ibid.*, p. 510.

was derived from such imports. In the first place, it is generally conceded that Canada's unfavorable balance of trade consisted largely of construction materials. If this statement is true, then Canada collected customs duties on materials used in the development of the country amounting to about $250,000,000 in 1912 and $300,000,000 in 1913. Secondly, no particular tariff item contributes an extraordinary amount of revenue. The greater part of the imports of tea, which in Great Britain provide a considerable revenue, entered Canada free of duty. Coffee is not generally consumed in Canada. Spirits and wines would provide about $2,000,000 per year and sugars would provide possibly as much more. Moreover, on April 6, 1914, Mr. W. T. White, minister of finance, stated that, of Canada's imports, a great part represented Canada's borrowings and found their way into works and undertakings of a constructive nature.[1] Undoubtedly, too, many imports of goods for immediate consumption were being consumed by workmen engaged in constructing the works which the Minister of Finance mentioned. There was, therefore, good reason for believing that should Canada's constructive epoch draw toward a close the government would find itself in a difficult position, owing to a decline of revenues.

While Canada's imports were meanwhile so great that her Consolidated Fund Account showed surpluses varying from $5,648,333 in 1901 to $56,630,366 in 1913,[2] yet her expenditures chargeable to capital, expenditures for railway subsidies, and for other purposes were so great that except for the years 1900, 1903, 1904, 1907, 1912, and 1913 her net debt was increased each year. In fact it rose from $268,480,004 in 1901 to $340,042,052 in 1911. It fell in 1912 and 1913 to $314,301,625.[3] Thus despite the enormous increase in customs revenues and excise collections the Dominion government added its contribution of about $50,000,000 to Canada's indebtedness between 1901 and 1913.

Canada's fiscal system might be conveniently summarized under four main points as follows:

1. The tariff was designed more for protection than for revenue.

[1] *Budget Speech*, April 6, 1914, p. 18.

[2] *Canada Year Book*, 1913, p. 509.

[3] *Ibid.*, p. 520.

2. The tariff nevertheless provided enormous revenues—a large share of the total revenues of the Dominion.

3. Customs duties on imports of goods used for construction purposes provided an important part of the customs duties and of the total revenue.

4. The net debt of the Dominion grew on account of heavy expenditures, and despite surpluses on Consolidated Fund Account.

Canada's fiscal problem may now be restated in more definite terms, as follows: Was her extraordinary constructive epoch approaching an end? Would imports of construction material and customs duties thereon decline to such an extent as to demand a reorganization of her whole fiscal system? What was the effect of the war?

III. THE EFFECTS OF INDUSTRIAL DEPRESSION

Fortunately or unfortunately, three events were imminent which might change Canada's economic organization and which might advise or necessitate a change of her fiscal system. The first was the financial depression of 1913 and thereafter, which carried through the world the financial effects of the Balkan wars. In Canada, thanks to a second factor, namely, the volume of Canada's accumulated borrowings and the necessity of beginning to pay the interest account in some more satisfactory way than by making additional borrowings, the depression was most severe. The third factor affecting Canada's financial outlook was the present European war. The first two were making themselves felt before Canadians could be persuaded that the third was possible. When war broke out Canada was well on her way through an economic readjustment.

Canada's adverse balance of trade from confederation until 1913 amounted to approximately $2,000,000,000. Another $300,000,000 was added in 1913.[1] Of course Canada had borrowed heavily, especially for the construction of canals and the Grand Trunk Railway, before confederation. One estimate of Canada's debts placed the total sum at $2,800,000,000 in 1913, bearing interest of $120,000,000 annually. Canada was therefore borrowing

[1] *Canada Year Book*, 1913, p. 228.

$120,000,000 in excess of her annual unfavorable balance of trade. Sooner or later interest and principle had to be paid by turning an adverse into a favorable balance. After Sir George Paish had visited Canada in 1912 and had given Canada some timely advice, most Canadians decided that borrowings would have to be curtailed in future. The real estate boom, which had been detrimental to Canada's best economic interests, came to a sudden end. People began to discriminate between cultivated fields and rural subdivisions. Though many owners of unimproved real estate refused to dispose of property at prices obtainable, there was nevertheless a steady decrease in the price of suburban real estate. The volume of building permits in cities fell off rapidly. The banks were less willing to extend loans. In the autumn of 1912 and winter of 1913 Canadian Pacific common stock fell from its high level of 286 to a few points above 200. The autumn of 1913 and winter of 1914 brought a continuation of the same conditions, together with much unemployment. Imports of the Dominion declined from $692,032,392 in 1913 to $650,746,797 in 1914, and exports increased from $393,232,057 in 1913 to $478,997,928 in 1914. The adverse balance fell from about $300,000,000 to $171,000,000.[1]

This change in business conditions in Canada had a marked effect on Canada's revenues. Whereas the expansion of revenues continued, although on a diminishing scale, until the end of September, 1913, so that the revenues for the six months, April 1 to September 31, exceeded those for the same months in 1912 by $5,499,065, between October 1 and the end of March, 1914, this increase had been turned into a decrease of $5,039,598 for the year ending March 31, 1914. As the receipts from sources other than the tariff held fairly well, the decline of $10,538,663 for the last six months of the year was due chiefly to a decrease in customs collections.[2]

Mr. W. T. White, Minister of Finance, thought, however, that the worst of the financial stringency was over and that normal monetary conditions would shortly return. He asserted that a borrowing country such as Canada, in the midst of a vast

[1] *Canada Year Book*, 1913, p. 228. [2] *Budget Speech*, April 6, 1914, p. 8.

constructive epoch in her history, could not suddenly discontinue her borrowings without the most serious risk of loss to British and other investors until railway and industrial undertakings had been finished and made productive. Since Mr. White expected additional borrowings and since he believed that a great part of Canada's imports represented her borrowings and were used for works and undertakings of a permanent character rather than immediate consumption, he could logically expect that Canada's revenues from the customs tariff would soon provide as large if not larger revenues than before the depression. As a matter of fact he calculated on an increase of revenues sufficient to recoup the earlier losses in some measure by April, 1915.[1] It is worth noting, however, that in the fiscal year 1914 Canada had already begun to export more and to import less and had succeeded in reducing her unfavorable balance of trade. Many, indeed, believe that she was nearing the date when her public works, her railways, and her industrial establishments would be practically adequate for a generation, and when, in short, the constructive epoch would be at an end.

The Treasury had not, however, seen an end of the decline in imports and in customs revenue. Whereas the months of April, May, June, and July, 1913, had shown an increase in customs receipts over receipts in the same months of the previous year, averaging $1,000,000 per month, the same months in 1914 had shown a decrease of $1,700,000 per month as compared with 1912, or a decrease of $2,700,000 per month as compared with 1913. In making his first war budget speech on August 20, 1914, Mr. White made an effort to prove that his earlier hopes for a return of prosperity—that is, for the second half of the constructive epoch—and for an increase in imports and customs receipts, had been justified. After referring to a general increase in commercial activity due to easier money conditions, he said that a marked improvement became perceptible about the end of July. The extent of this improvement was reflected in the returns of the first ten days of August. The loss of revenue as compared with the previous year being then only $500,000, or at the rate of $1,500,000 per month,

[1] *House of Commons Debates*, August, 1914, p. 24.

as compared with an average decline of $2,700,000 for each of the four preceding months, the government had calculated that during the remainder of the calendar year the Treasury would gradually overtake the revenues of the corresponding months of the previous year and could look forward to gains in January, February, and March, 1915, which would have recouped in some measure the earlier losses by providing a revenue of $145,000,000. Mr. White then went on to explain that the outbreak of war had wholly changed the outlook and that, on account of the war, the government could not expect a revenue of more than $135,000,000. At that time the opposition did not question the attitude of the government, but when, in the winter session of 1915, Mr. White repeated his statement that the war was responsible for the increases in taxation, Liberal newspapers and the Liberal party in the House of Commons challenged that opinion. Thus began the parliamentary discussion of a subject concerning which there has been much controversy in and out of Parliament.

Of course it will never be possible to say definitely how serious Canada's fiscal problem might have been had the war not occurred, for it began at the very moment when it appeared to some people that what Mr. White called "the second half of the constructive epoch" was just beginning. It is not altogether useless to venture an opinion, but in so doing one must take into consideration evidence which was not available until after the war began. It is therefore desirable that the statement of such an opinion should follow rather than preface a statement of the effect of the war on financial problems in Canada.

IV. THE EFFECTS OF THE WAR

The first results of the war were doubtless adverse to Canadian economic interests. There was an instantaneous and universal demand for gold. Large volumes of securities were thrown on the markets and sold for what they would realize, and liquidation proceeded upon such a scale that the stock markets in Canada, as elsewhere, were closed. Suspension of specie payments seemed imminent, and for a few weeks international trade was prostrated by the blow and the insecurity of travel on the high seas. There were

grave fears that Canada would find great difficulty in financing her many obligations, public and private.

As we have already seen, the Minister of Finance took some trouble to explain that the government was about to realize its hopes for a return of prosperity and an increase of customs collections when war broke out. His opponents lacked definite information with which to challenge his opinion, for not even the Minister of Finance could forecast the course of trade. What facts he had were meager indeed, but he made the most of them. After mentioning the increase of commercial activity due to easier money conditions he referred to the increase of customs duties during the first ten days of August. What reason he had for basing his arguments on conditions that came into existence when war seemed inevitable or after it had been declared is not plain, unless it was to support his prophecies of April, 1914. As a matter of fact there is as good reason for attributing the increase of revenue during the first ten days of the war to the war itself. When it was already apparent that Canada's revenues had fallen off and when it was known that the Canadian Parliament would have to approve war measures, including a war budget, it was only natural that Canadian importers should take large quantities of goods out of bond in order to escape increases of duties. It is not surprising then that figures of imports and revenues showed an increase in the first ten days of August. What they were on the second ten days Mr. White did not inform the House, probably because the returns were not available, possibly because they did not support his opinion. In any case, Mr. White's evidence was valueless. In this respect, as in others, the first effects of the war soon disappeared, and revenue collections declined again.

Contrary to expectations, however, Canada recovered from the first effects of the war with remarkable ease. Within a few weeks the machinery of commerce and finance began to resume its normal function. There are good reasons for believing that Canada's national position is now approaching a condition which must inspire the greatest confidence. On this point one could not do better than to quote liberally from "Why the National Position is Good,"

an article published by the editor, Mr. Fred W. Field, in the *Monetary Times* of May 28, 1915.

In the first place, the war put an end to real estate speculation. Of course there had been a general reaction from the long period of rapid development and speculation and a much-needed readjustment of economic conditions had set in before the war came. "The speculative sugar of 1912 has been cleaned out of the national larder. The complaints are that these are not the palmy times of those boom days. This is also true, but we may as well recognize that the country is on a good plain business diet." More recently trading in war specialty stocks has opened a new sphere for speculation, but it does not attract so many people as did the real estate movement.

Secondly, "for the first time on record the total deposits in Canadian banks exceeded $1,000,000,000, the figures being $1,016,390,076. Of this sum the deposits payable after notice (the savings of the people) totaled $676,875,790, or $31,000,000 more than in March, 1914, and $47,000,000 more than in March, 1913." In June, 1915, they had risen to $691,891,287.[1] Bond houses report a fairly good demand for first-class securities. One should add to the increase in savings $28,000,000 raised at home for capital expenditures as compared with $45,603,000 for the whole year 1914.

Undoubtedly, too, war orders are improving this situation, for a time at least. The *Monetary Times* estimates that war contracts received in the first six months of 1915 amount to $394,000,000 and that for the entire current year they will exceed $500,000,000. They cover a large number of industries, including leather, automobile, iron and steel, lumber, milling, etc. Canadian manufacturers know, however, that they cannot depend on war orders for general and permanent prosperity. Orders for $500,000,000 would keep Canadian factories, which are capable of producing goods worth $1,400,000,000 annually, busy but one-third of a year. Nevertheless these war orders are very acceptable at the present time. They provide work for many who would otherwise be unemployed; they call for an increased output of raw materials, especially iron and steel; no doubt they necessitate the importa-

[1] Bank statements, March and June.

tion of some raw materials and occasion the payment of customs duties; best of all they represent cash payments. Profits on war contracts may yet pay for a considerable share of Canada's war expenditures. There has been a tendency, however, for Canadian manufacturers to forget the necessity of ultimately "scrapping" much of the machinery necessary for making war materials. That item, which must be considered in the future, is not troublesome at present; consequently war orders are providing one element of present if temporary prosperity.

Canadian manufacturers are also cultivating the domestic market and are planning a greater export trade. They will doubtless be able to meet the demands of the domestic market after the war is over, if they were not able to do so before. For instance, the capacity of steel rail mills is quite adequate for normal demands in recent years of prosperity and more than adequate for periods of depression. A slight decline in railroad building would put an end to the importation of steel rails. The export business is being encouraged by the Export Association of Canada, backed by the Canadian Manufacturers' Association. As yet war orders have been the chief cause of the increase of exports of manufactures from $57,443,452 for the fiscal year 1914 to $85,539,501 in 1915. There is now more foreign business than Canadian steel companies can accept. There is no doubt, however, that war orders will provide an attachment which will secure permanent foreign markets for many lines of manufactures.

The development of agriculture has been another favorable factor. Doubtless the war was the chief means of suddenly turning the attention of many people toward agriculture. While the crop of 1914 was a comparative failure, yet wheat and oats sold at such extraordinarily high prices that the value of these agricultural products was increased. Encouraged by high prices, and to a certain extent by the "Patriotism and Production" campaign, the farmers have increased the acreage of field crops by 15 or 20 per cent. Undoubtedly the value of agricultural produce in 1915 will exceed the value of 1914 ($638,580,300), by $100,000,000.

Canada had not, however, completed her construction work when the war broke out. A greater railroad mileage is under con-

struction than in the United States, and the Dominion government is spending $32,000,000 on large undertakings outside the department of railways and canals. Other great works, such as the Greater Winnipeg water supply scheme, the Halifax ocean terminals, the Quebec Bridge, the Toronto Bloor Street viaduct, together with a fairly large amount of municipal local improvement work, are being begun or completed.

After the outbreak of war and even during the winter session of the House of Commons the government constantly argued that the new taxes imposed were made necessary by war conditions. Particular emphasis was placed on the opinion that Canada was no longer able to borrow heavily for construction purposes or to import construction materials. Of the speeches on this subject, that by Sir George E. Foster, minister of trade and commerce, on March 15, was by all means the best. He said in part:

> In the first place when war broke out capital was affected. . . . . The borrowing power of this country was absolutely cut off. . . . . As borrowing was stopped . . . . foreign credits were not longer given. . . . . Orders involving in the aggregate vast sums of money which had been placed in other countries by Canadian interests were at once absolutely and definitely cancelled. . . . . Revenues decreased because imports decreased; imports decreased as a result of the causes to which I have referred.

Mr. White held that Canada could not stop borrowing a million dollars a day in the form of imports without experiencing a decrease in revenue. He called attention to the experience of the United States and of Australia, and pointed out that if the United States, a developed country and a neutral nation, needed to impose war taxes to provide the revenues that had been expected from customs duties on imports, surely Canada, a belligerent nation, would need additional taxes in times of war.[1]

But, contrary to the opinions on which the government justified its war taxation, Canada did not end her period of borrowing for domestic purposes at once. Before war broke out, Mr. White, in spite of prevailing opinion, believed that Canada's constructive epoch was little more than half over. It certainly was not yet completed, for, as we have already seen, huge expenditures are still

[1] *Debates*, 1915, pp. 896–97.

being made on large works, public and private. Consequently, whereas Canada borrowed from England $272,935,000 in 1913 and $173,795,000 in 1914, and from the United States $53,944,000 in 1913 and $50,720,000 in 1914, in the first six months of 1915 she borrowed from England $41,000,000 for purposes other than the war and from the United States $60,297,000. Canada is that much nearer the end of her borrowings for domestic purposes.

In addition, Canada has borrowed on war account to the end of July about $100,000,000. At present the war is costing Canada about $500,000 per day; all of which she is borrowing.[1] It will cost about $200,000,000 or more per year as long as it lasts. How long Canada will continue to borrow for war purposes it would be difficult to suggest.

Funds for war purposes have so far been advanced to Canada by the imperial government. While the London market was practically closed to all but war loans, the Dominion government was able to secure $41,000,000 for public works during the first six months of 1915. The financing of provincial governments, corporations, and municipalities has been accomplished almost wholly in the United States. Seven provincial governments raised nearly $30,000,000 in New York during the first five months of 1915. Since the Dominion government raised $45,000,000 in New York in July it may be taken for granted that the United States will provide Canada with whatever capital she borrows for domestic purposes until the war is over and possibly for years afterward.

The most notable feature of Canada's present economic conditions is the existence of a favorable balance of trade in merchandise. That Canada would soon have to alter her international trade relations had been predicted by many. She had already begun to change them in the fiscal year of 1914 by reducing the unfavorable balance of trade from about $300,000,000 in 1913 to $172,000,000 in 1914.[2] In 1915 Canada's exports of all kinds were valued at $490,808,877; her imports were worth $587,364,363. The balance of trade had declined to less than $100,000,000. It has been customary to include figures of trade in coin and gold bullion in

[1] *Toronto Telegram*, July 31, 1915.

[2] *Canada Year Book*, 1913, p. 228.

Canada's trade figures, and as the imports or exports seldom exceeded five or ten millions their inclusion was not a serious error. Owing, however, to the serious disturbances of the last year in international exchanges, imports of gold coin and bullion, which were, in 1914, $15,235,305, increased to $131,992,992. Exports increased from $23,500,704 to $29,366,368. In other words, whereas Canada imported merchandise worth $618,328,884 in 1914, she imported $455,371,371 in 1915; imports of merchandise declined by $163,000,000. As exports of merchandize were $461,442,509, Canada had a favorable balance of trade so far as merchandise was concerned.[1]

The effect of the depression and of the war on Canada's revenues produced a serious problem for the Canadian government. It matters little whether the difficulty should be attributed to the war or to the depression, to the Conservative party or the Liberal party. Even if it should appear that the depression has been the chief cause of financial difficulty, one might as well admit that one political party was as much responsible as the other. The *tu quoque* arguments of political partisans are not at all out of place in attempts to place political responsibility. It is difficult to place responsibility on any one party or any one factor. What is more important is the necessity of acknowledging that Canada is probably face to face with the most serious fiscal problem in her history. The following summary of evidence bears out this conclusion:

1. A readjustment of Canadian economic conditions had set in before the war began. Construction activities had slackened; speculation was checked; imports of raw material had declined; the unfavorable balance of trade had decreased and revenues from customs had fallen off. Since the outbreak of war the unfavorable balance of trade had practically disappeared.

2. Canada's borrowings amounted to about $2,800,000,000 before the outbreak of war; her interest charges were about $120,000,000 per year. Canada would need a favorable balance of trade of over $120,000,000 before she would be paying her interest bill, apart from interest on war expenditures and on debts accumulated since August, 1914.

[1] *Monetary Times*, May 28, 1915.

3. The increase in the value of agricultural products in 1915, together with war orders, will probably relieve the Canadian situation considerably. In these respects the war will increase Canada's purchasing power. Mr. Fred W. Field, of the *Monetary Times*, believes that "the war has kept Canada from sliding to the point to which it deserved to slide as a result of economic sinning." Sir Edmund Osler, M.P., president of the Dominion Bank and vice-president of the Canadian Pacific Railway, believes that the war saved Canada.[1] It may be that Canada has actually imported more and has collected greater revenues than she would had the war not come.

In any case, Mr. Field is undoubtedly right when he says that "unbiassed observers of the situation in Canada agree that extra taxation would have been inevitable whether or not the war had come." In other words, the change in Canada's economic outlook would have forced a serious revision of her fiscal system. She could no longer depend on such large collections of customs duties, especially the duties on materials for construction purposes.

5. While the war may have benefited Canada temporarily, an increase in the public debt amounting to $150,000,000 or $200,000,000 annually for war purposes alone will tax Canada's ability to pay the interest and principal of her financial obligations still further. There is an economic limit on Canada's borrowing powers, and the increase in governmental debt will reduce the possibility of borrowing for purposes other than the war. Mr. White was probably right in saying that "Until the war is ended and for a considerable period after it is not probable that monetary conditions will permit the issue of securities of even the highest character for other than war purposes in any such volume as that to which we have been accustomed."[2]

6. During the last fiscal year imports of merchandise decreased by $163,000,000, but Canada was still borrowing the interest on past debts as well as borrowing for war purposes. In order to pay the interest of $120,000,000 she will have to increase her exports or decrease her imports, or both. It would be a remarkable occurrence indeed if after increasing her exports of merchandise from

[1] *Debates*, 1915, p. 917.

[2] *Ibid.*, p. 94.

$290,223,857 in 1913 to $455,437,224 in 1915, about $55,000,000 per year, she should increase them to $600,000,000 or more within another year or two in order to pay interest charges. That is too much to expect. There is a greater probability that the volume of imports will decline again in the fiscal years 1916 and 1917 and that the fiscal problem will therefore become even more serious than it is today.

V. THE BUDGET OF AUGUST, 1914

Solutions of financial crises are usually provided by instalments. At the first war session, Mr. White did not attempt to introduce legislation that would close up the probable gap between expenditures and revenues. In February, 1915, he made a more serious attempt, but the evidence seems to show that the first two instalments of financial legislation will be inadequate to solve Canada's fiscal problem.

On August 20 Mr. White presented the first budget speech since war broke out. On August 21, $50,000,000 was voted for "the defense and security of the country, for the conduct of naval and military operations in and beyond Canada, for promoting the continuance of trade, industry, and business communications whether by means of insurance against risk or otherwise, and for carrying out any measures deemed necessary or advisable by the Governor-in-Council in consequence of a state of war." The Governor-in-Council was also empowered to raise by way of loan, temporary or otherwise, such sums of money as were required for the purposes of making the payments authorized.[1] It was expected that about $30,000,000 would be expended during the fiscal year ending March 31, 1915.[2]

The government also made the announcement that so far as possible the existing program of public works which were already under construction or in contemplation, and which might be reasonably expected to be productive to the nation, would be continued, but that no new expenditures would be undertaken until the money was on hand to pay for them.[3] Mr. White doubted whether it would be possible to borrow heavily abroad and expected

[1] *Debates*, August, 1914, p. 43. [2] *Ibid.*, p. 25. [3] *Ibid.*

that Canada's imports would decline rapidly. He expected a revenue of $130,000,000, which would just about suffice to meet ordinary running expenditures until the end of the year. This, however, left unprovided for $30,000,000 of capital, special and investment expenditures, $30,000,000 of war expenditures, and $8,500,000 for the retirement of treasury bills in November, 1914. As the government had borrowed $25,000,000 in June, a balance of at least $43,500,000 would have to be met by additional borrowing or by an increase of taxation.

The least important part of the war measures of August provided for an increase of customs duties on coffee, sugar, liquors, and tobacco, and of excise duties on liquors and tobacco. The chief changes of customs duties were as shown in Table I.

TABLE I

Tariff Item	Description	Tariff Rates			
		Preferential		General	
		Old	New	Old	New
28 ...	Green coffee, imported direct or purchased in bond in the United Kingdom, per lb	Free	$0.0225	Free	$0.03
134 ...	Refined sugar testing not more than 88 degrees, per cwt.....	$0.72	1.52	$1.08	1.93
134 ...	For each additional degree, per cwt......................	0.01	0.01	0.015	0.0133
135....	Raw sugar testing 56 to 75 degrees, per cwt............	0.315	0.88	0.52	1.1125
135....	For each additional degree, per cwt......................	0.01	0.0075	0.015	0.0125
156....	Whiskey, brandy, gin, and other distilled spirits, per proof gal.	2.40	3.00	2.40	3.00
143....	Cigars and cigarettes, per lb ...	3.00	3.50	3.00	3.50
145....	Manufactured tobacco, per lb..	0.50	0.60	0.50	0.60

Certain other minor changes, known as consequential changes, were introduced on account of increases of duties on these raw materials for the manufacture of other articles—as, for instance, on ground and roasted coffee made from green coffee, or confectionary made with sugars—or because other articles, such as chicory or cocoa, might be used as substitutes. The duties on wines and champagnes were not increased, on account of Schedule C of the

French commercial treaty, which provides that the customs rates thereon are to be specific and not susceptible to increase during the continuation of the treaty. It was expected that the duties would provide an additional revenue of $8,000,000 before March 31, 1915. Coffee would provide $500,000; sugar $5,000,000; liquors $2,500,000, and tobacco $200,000. The changes in excise duties were as given in Table II.

TABLE II

Article		Duty	
		Old	New
Spirits	Per gal.	$1.90	$2.40–2.43
Malt liquor	" "	0.10	0.15
Malt	Per lb.	0.015	0.03
Manufactured tobacco	" "	0.05	0.10
Cigars	Per 1,000	2.00	3.00
Cigarettes weighing not more than three pounds per thousand	" "	2.40	3.00

Other slight changes were made in respect to cigars and cigarettes in packages. A revenue of $6,600,000 was expected of the increase in excise duties before the end of the fiscal year 1915. It was also provided that the customs duties on liquors and all excise duties should be deemed to have come into force on August 7, since certain brewers, distillers, and dealers in expectation of special war taxes had taken large amounts out of bond prior to the date of the budget speech. Customs duties and excise duties together were expected to produce an additional revenue of $14,600,000 before March 31, 1915.

During the August session there was very little criticism of the budget. A truce was declared by the Liberal party and accepted by the Conservatives. The duties, both excise and customs, on liquors and tobacco met with general approval. Mr. White claimed, in answer to a suggestion that the increases had not been high enough, that the duties were at the point beyond which the government could not go in the interests of revenue. Some exception was taken to the duties on coffee and sugar because they would affect the poor, who were already suffering from war conditions.

Specific duties always bear most heavily on the poor, who use the cheaper qualities of goods. Mr. Carvell suggested that "consequential duties" should have been omitted, so that the manufacturers as well as consumers would have to contribute.[1] A graded income tax, taxes on patent medicines, on fancy matches, and on exports of pulp wood and pulp were all suggested as alternative or additional measures. Mr. A. K. MacLean pointed out that the government would have to retrench. All of these suggestions and criticisms, however, reappeared when the government presented its second instalment of the solution of this financial problem, and they may therefore be reserved for more adequate discussion when the budget of 1915 is discussed.

The second fiscal measure of the August war session was an amendment of the Dominion notes act. Previously this act had provided for the issue of $30,000,000 of notes on a gold margin of 25 per cent. Issues in excess of this sum had to be secured by gold coin, dollar for dollar. By the amendment it was provided that $50,000,000 could be issued against the 25 per cent margin, and that an excess could be issued against either gold coin or gold bullion, dollar for dollar. In this way the government was able to issue $15,000,000 more notes, on which it need not pay interest, without increasing the gold reserve.[2] Full advantage was taken of this amendment; in fact, the government issued $10,000,000 in excess of the $15,000,000 authorized and got special confirmatory legislation in the winter session of 1915.[3]

This method of borrowing provided the government with $25,000,000 at no cost to itself. It did not, however, lead to a depreciation of Dominion notes, for the reason that gold reserves remained quite ample and there was no danger that the government would be unable to redeem its notes on demand. There is not likely to be a demand for the redemption of a large volume of notes at any one time. As the Canadian bank act requires that 40 per cent of the reserve fund of Canadian chartered banks shall consist of Dominion notes and as the banks are not permitted to

[1] *Debates*, August, 1914, p. 72.

[2] *Budget Speech*, August, 1914, p. 20.

[3] *Budget Speech*, February 11, 1915, p. 8.

issue their own notes in denominations of less than five dollars, Canadian banks had found it necessary to have on hand $90,588,065 of Dominion notes on July 31, 1914. As the public held $22,205,-768 of notes which it had received through the banks, the total issue of notes was $112,793,833. The government held a gold reserve of 81 per cent, or $91,735,584. When full advantage had been taken of the amendment the gold reserve was still 71.7 per cent of the issue, and when the additional issue of $10,000,000 was made the reserve was 66.5 per cent of the issue. The reserve had been 22 per cent in 1870; 41 per cent in 1880; 34 per cent in 1890; 55 per cent in 1900; and 65 per cent in 1908.[1] Ordinarily a large share of the notes in the hands of the public never come in for redemption until they are practically worn out, because they are needed for cash transactions. The banks, too, need a very large amount of notes for the purpose of making clearings. On July 31, 1914, the banks held $80,404,000 of "bank specials" in denominations of $5,000, $1,000, and $500, which are used for this purpose. In other words, it is only in exceptional periods that there might be a "run" on the gold reserve of the government; yet the best way to prevent such an occasion is to keep the proportion of the reserve to the issue up to the highest possible level. Moreover, it is not well to encourage governments to borrow, without having to pay interest, in this way; and it must be admitted that an inexperienced minister of finance might be tempted to draw too heavily on its possibilities. It is to be hoped that this method of financing will be carried no farther.

After the outbreak of war the contraction in customs revenue, which was fairly constant each month, amounted to about one-third of the returns for the corresponding period of the previous year. However, the additional excise duties of the August budget had the effect of counteracting the heavy losses which would otherwise have been experienced. A revenue of about $130,000,000 was received. Expenditures, however, amounted to $140,000,000 on Consolidated Fund Account and $50,000,000 for capital and special accounts other than the war; a total of $190,000,000. The full amount of the war appropriation of $50,000,000 was expended. In

[1] *Debates*, August, 1914, p. 62.

addition, the Dominion made advances on investment account and met its sinking fund obligations of $5,000,000 as usual and provided for the retirement of $1,700,000 of Treasury bills in November. In other words, current revenue was entirely inadequate.

As we have already seen, $25,000,000 of Dominion notes were issued without an increase of gold reserve. Despite the difficulty of borrowing in Great Britain the government arranged with the imperial government for advances of £12,000,000 between September, 1914, and March 31, 1915. It also issued £3,000,000 of six months treasury bills at $4\frac{1}{2}$ and $4\frac{1}{4}$ per cent maturing in June, 1915; it sold at a net price of $94\frac{1}{2}$, £1,300,000 of 1940–60 stock in London; and borrowed $5,000,000 from the Bank of Montreal. In short, it borrowed about $110,000,000 in order to arrange its finances until the end of March, 1915.[1]

VI. THE BUDGET OF FEBRUARY, 1915

It was quite plain that Canada would need additional revenues in the fiscal year of 1916, and it was generally conceded that the Minister of Finance faced a serious difficulty. With imports declining, there was little hope that the fiscal measures in existence would provide as great a revenue as in 1915. Mr. White admitted that the revenue from all sources would not exceed $120,000,000. Yet expenditures were to continue at practically the level of the previous year; namely, $140,000,000 on Consolidated Fund Account and $40,000,000 for capital and special account. There would be $4,000,000 needed for investments already authorized, $3,000,000 to meet maturing Treasury bills, and $5,000,000 for the Bank of Montreal. Special war expenditure might reach $100,000,000 and interest charges would be greatly increased. Mr. White estimated that the total cash requirements for all purposes, including war expenditure, would amount to $300,000,000. It was therefore apparent that Canada was forced to raise $180,000,000 or more by borrowing and by additional taxation. Mr. White proposed to meet the situation as follows:

1. He proposed to negotiate for a renewal of the arrangements to borrow from the imperial government the total expenditure for

[1] *Budget Speech*, February, 1915, pp. 8–9.

the war, paying the same rate as is paid by the imperial treasury on its war loans from the proceeds of which advances had been made to Canada in the fiscal year 1915. At such time or times in the future as may be agreed upon by the British Chancellor of the Exchequer and the Canadian Minister of Finance a Canadian war loan will be issued and the borrowings from the imperial government repaid.

2. He introduced a bill entitled "The War Revenue Act, 1915," which provided for the following special and general taxes, which were calculated to raise a sum of $8,000,000:

a) On banks a tax of 1 per cent upon the average amount of notes outstanding.

b) On trust and loan companies, including banks organized under the Quebec Savings Banks Act of 1913, a tax of 1 per cent on the gross income from loans, investments, and business in Canada.

c) On insurance companies, other than a life insurance company, a company transacting marine insurance, a fraternal benefit society, and a purely mutual company, registered and licensed to do business in Canada, a tax of 1 per cent on the net premiums received by them in Canada.

d) On cable and telegraph messages and dispatches, other than press dispatches, a tax of one cent on all messages for which a charge of fifteen cents or more is imposed.

e) On railway tickets a tax of five cents when the regular charge is over one dollar and not more than five dollars, and an additional tax of five cents for each additional five dollars or any fractional part thereof; on tickets for sleeping-car berths a tax of ten cents and on tickets for a parlor car seat a tax of five cents; on boat tickets a tax of one dollar if the amount chargeable exceeds ten dollars, three dollars if the amount exceeds forty dollars, and five dollars if the amount exceeds sixty-five dollars.

f) On checks, bills of exchange, promissory notes, and receipts, a tax of two cents.

g) On money orders, travelers' checks, and postal notes a tax of two cents.

h) On letters and postcards a tax of one cent.

i) On proprietary medicines and perfumery a tax of one cent on each bottle or package retailing for twenty-five cents or less, and one cent for each additional twenty-five cents or fractional part of twenty-five cents.

j) On wine, non-sparkling, a tax of three cents on one pint or less, five cents on one quart or less but more than one pint, and five cents for each additional quart or any fractional part thereof.

k) On champagne, or sparkling wine, thirteen cents on one half-pint or less, twenty-five cents for one pint or less but more than one half-pint, and twenty-five cents for each additional pint or any fractional part thereof.

3. As a main revenue measure which would provide about $25,000,000 Mr. White proposed that on February 12, 1915, there should be, with certain exceptions, a general horizontal increase of the customs duties upon all goods and commodities imported into or taken out of bonded warehouses in Canada, whether previously dutiable or free, or raw material, partly finished or finished products, amounting to $7\frac{1}{2}$ per cent ad valorem under the general and intermediate tariffs and 5 per cent under the British preferential tariff. Duties on iron ore, which had previously entered Canada free of duty, were made specific at six cents per ton under the preferential tariff and 8 cents under the general tariff. In determining the list of exceptions regard was had to Canada's trade convention with France and the obligation of an agreement with the British West Indies. By reason of the French convention the increases of customs duties did not apply to silk fabrics, velvets, ribbons, embroideries, and certain other goods. Other exceptions were wheat, flour, tea (free), anthracite coal, fish from Newfoundland, salt for curing fish, lines, twines, nets and hooks for fisheries, reapers, mowers, binders, harvesters, binder twine, traction ditching machines, sugar and tobacco (which had been dealt with in August), news printing paper, newspaper printing presses, typesetting and typecasting machines, and a number of other articles of lesser importance. Bananas were exempted when representations were made to the government by the British West Indies. The regulation which provided that manufacturers are entitled to a drawback of 99 per cent of all duties paid on imported materials

used in the manufacture of articles in Canada and exported therefrom was of course continued.

4. Mr. White proposed to borrow, in whatever market was open, whatever other funds were necessary, probably about $50,000,000.

The Conservative party undoubtedly expected that the Liberals in oppostion would maintain as uncritical an attidude as in the August session. Newspapers had, however, pointed out that the government needed helpful criticism and that is was the duty of an opposition to provide it. The opposition undoubtedly had as much right and as great a duty to perform when they criticized the financial proposals of the government as when they called for investigation of army purchases, but when predictions were made that a war election would shortly be held, the political truce was soon broken and helpful criticism was displaced by what on many occasions amounted to partisan obstruction.

The criticism of the character of the new war taxes was not serious. The tax on bank note issues seemed popular and many believe that it will be permanent. One might add that there is as good reason for taxing demand deposits of banks as for taxing bank notes. The difference between bank notes and demand deposits is merely one of convenience and form. Both are demand liabilities. The tax on notes has the merit of providing $1,000,000; a tax on demand deposits would provide an additional $3,300,000. A tax on current loans, or, better still, on the gross income, of the banks would have been more desirable. The gross income of loan and trust companies was taxed in this way. Some objection was taken to the exemption of purely mutual fire insurance companies, and the failure to tax the premiums collected by representatives of foreign companies was vigorously condemned.[1] The exemption of press dispatches was to be expected, since all newspapers would have opposed them. Sir Wilfred Laurier thought that the taxes on railway tickets should have been graduated so that the burden would fall most heavily on the traveler in Pullman and parlor cars,[2] but Mr. White pointed out that too heavy a tax on railway tickets would encourage travel over American railways.[3] Druggists protested against the tax on patent medicines[4] and it was suggested

[1] *Debates*, 1915, p. 1236. [2] *Ibid.*, p. 888. [3] *Ibid.*, p. 906. [4] *Ibid.*, p. 612.

that this was a tax on the medicine of the poor.[1] While the stamp duty on wines was doubtless legalized by making it a stamp tax rather than a customs duty, yet a stamp duty that must be paid before the goods pass out of the customs house is certainly a violation of the spirit of the French convention.[2] The stamp tax on letters was of doubtful value. In August, 1914, Mr. White was not at all certain that an increase of one cent in the postal rate would not have the effect of decreasing rather than increasing the revenue. He admitted that it would fall on all classes of the community. He therefore objected to the proposal that the opposition made.[3] In 1915 the Liberals objected when Mr. White adopted their suggestion. There is this at least to be said in favor of this tax, that it is a charge for a service, which is more than can be said for most taxes.

The taxes on commercial paper, such as checks, bills of exchange, and receipts, were much misunderstood in and out of Parliament. The government was therefore wise in deferring their enforcement until April 15. Evasion of these taxes was carefully provided for. Evasion of the tax on bills of exchange was protected against by the tax on checks, and evasion of the tax on checks was limited by the tax on receipts.

In general it may be said that the new taxes provided for the collection of revenue from those best able to pay and that, with the exception of the failure to tax banks scientifically and to tax the Canadian business of foreign fire insurance companies, very little objection can be raised against them. The chief objection raised by the opposition was that the government did not resort to more taxes of the kind, especially succession duties, a land tax, corporation taxes, and the income tax.

But the suggestion that direct taxation should have been extended was merely the half-hearted attempt to provide a constructive side for the criticism of Mr. White's chief means of increasing the revenue, namely, the horizontal increase of customs duties. These were denounced by Mr. Michael Clark as a "sacrifice to the Moloch God of protection." Mr. W. C. Goode, master of the Dominion Grange, said, in an address to the fortieth annual meeting,

[1] *Debates*, 1915, p. 961. [2] *Ibid.*, p. 613. [3] *Debates*, August, 1914, p. 71.

that "the tariff changes would have the net effect of enabling domestic producers to tax domestic consumers." He declared that "wild and stupid are mild terms to apply to the recent policy of the federal government; doubly wild and stupid at present when the need of stimulating agriculture is paramount." The duties on agricultural implements made a poor running mate with the campaign of "Patriotism and Production."

That the Conservatives had in mind an increase of protection is evident from the fact that Mr. White believed that the duties would stimulate industry and agriculture and relieve unemployment.[1] Mr. Claude Macdonell seemed to regard the increase in duties as permanent.[2] Certainly the Conservative party believes that the protective principle is firmly established in Canada. The *London Economist* was quoted in the House as follows: "We are strongly of the opinion that this addition to the cost of living in a new country where prices were already high will cause much hardship and discontent. Many of these taxes are protective so that the revenue secured will be much less than the burden imposed on consumers." There is no doubt that the increases were in line with the traditional policy of the Conservative party.

The method of increase was also severely criticized. It gave no consideration to the special characteristics of individual items, to the changes in trade conditions, or to the amount of revenue that the Treasury was likely to receive. In many cases it was a shield for increases of protection that would prove prohibitive of importation.[3] It was attributed to the government's desire to avoid going over the tariff item by item,[4] or to avoid framing a tariff designed chiefly in the interests of revenue.[5] The horizontal increase extended to articles that had previously been on the free list, many of which, like iron ore and raw wool, were being imported in large quantities. The net effect of this increase would be very uncertain. At first many believed that the tax would benefit them. Manufacturers are prone to welcome any increase of the tariff. Yet the fact is that a protective tariff is from its very nature a compromise and a set of discriminations, and what helps one injures

[1] *Debates*, 1915, p. 98.
[2] *Ibid.*, p. 841.
[3] *Ibid.*, p. 393.
[4] *Ibid.*, p. 609.
[5] *Ibid.*, p. 889.

another. The horizontal tariff, from the very fact that it does not discriminate, will not have so many friends as if it had shown discrimination. The manufacturer, for instance, will have to pay $7\frac{1}{2}$ per cent on his raw material; one can be fairly certain that he will not favor the continuation of the horizontal increase. The probability is that the manufacturer will want the duties on raw materials reduced and those on the finished articles retained.

Whether the demands for revenue will permit of such a method of revision is uncertain, for the horizontal increase is probably providing more revenue than would have been provided by increases on finished goods alone or on goods previously dutiable. In 1913, $208,000,000 of free goods were imported, $30,000,000 from the United Kingdom and $146,000,000 from the United States. The duties on these raw materials will probably provide over $12,000,000 or possibly $15,000,000 of the $25,000,000 expected.[1]

When Sir Wilfred Laurier, leader of the opposition, moved an amendment to the War Revenue bill, he attacked it at a point where he might expect to make some political capital, in these days of strong imperialist sentiments in Canada, by opposing the increase of duties under the British preferential tariff as a blow to British trade. The opposition seemed to be trying to spread the impression that the British preference would be decreased. On the contrary, on goods which had previously entered Canada free of duty so that there was no preference, Great Britain now had a preference of $2\frac{1}{2}$ per cent. The preference had been increased by $2\frac{1}{2}$ per cent on all other goods and the rates of duty under the preferential tariff remained about 66 per cent of the rates under the general tariff. At one point especially the Liberals had a sound argument on this subject, namely, when they stated that the increase of insurance and of freight rates for ocean traffic had neutralized a considerable part of the preference. On the whole, Great Britain was probably benefited by the change; at least, as compared with other countries. She would have benefited still more had the suggestion of Sir Wilfred Laurier been adopted. But as the revenues received on goods from Great Britain on account

[1] *Debates*, 1915, p. 1064.

of the increase of 5 per cent will probably be considerable, the government had a good reason for voting down the amendment.

The expenditure side of the government's fiscal policy received a good deal of attention during the winter session of 1915. Charges of graft were popular and, as it turned out, justified. One Liberal declared that the opposition would vote "millions for war but not a dollar for graft."[1] Apart from graft the new taxes were attributed to the failure to reduce expenditures when the depression set in.[2] "Economy and retrenchment did not belong to the vocabulary of the Conservative party."[3] Mr. White claimed, however, that a reduction of $14,833,000 had been made in the estimates for public works[4] and further claimed that by eliminating every possible expenditure it would puzzle one to produce an economy of $30,000,000 and still do duty to the public administration and the services of the country.[5] He explained also that the government had introduced many revotes, so that if the war ended and conditions became normal within the fiscal year 1915–16 the works could be gone on with.[6] Mr. Claude Macdonell expressed another policy of the government when he said that war conditions made it imperative for the government to do all it could to provide employment,[7] but of course he did not explain why it was necessary to construct public buildings, many of them largely ornamental, and others, like armories and drill sheds, useless while the war lasts, in small towns where unemployment was practically unknown; or that out of $3,000,000 spent on the harbor of St. John in 1914–15 only $300,000 was paid directly to labor.[8]

In discussing this subject, as others, *tu quoque* arguments were frequently used. Mr. White talked of inheriting expenditures provided for when the Liberals were in power. The opposition in reply gave evidence of large and new expenditures.[9] The *Toronto Globe* of February 15 said that the government was "spending money like a drunken sailor." A compilation of dismissals, resignations (many of them forced), desertions, and new appointments in the civil service shows that there had been a net increase of

[1] *Debates*, 1915, p. 964.
[2] *Ibid.*, p. 384.
[3] *Ibid.*, p. 886.
[4] *Ibid.*, p. 657.
[5] *Ibid.*, p. 1063.
[6] *Ibid.*, p. 618.
[7] *Ibid.*, p. 397.
[8] *Ibid.*, p. 603.
[9] *Ibid.*, p. 1071.

12,147 between October 10, 1911, and February 9, 1915.[1] The *Civil Servants' Magazine*, of Ottawa, declares that there is an overmanning of the service to a remarkable degree and that on account of duplications and other kinds of waste there is a loss conservatively estimated at over $5,000,000 a year.[2] Sir Thomas Shaughnessy, of the Canadian Pacific Railway, says that an examination of the estimates of the government does not show that the same drastic cut has been made in the cost of administration of public offices which has been made by the Canadian Pacific Railway or any other well-conducted business.[3] No doubt the expenditures could have been reduced at many points.

The worst feature of the war measures is that they are inadequate. During the first three months of the present fiscal year there was a net decrease of revenue of $332,262 as compared with the previous year. In July there was a net gain of $133,463 over the revenue for July, 1914. There has therefore been a net decrease of revenue for the first four months amounting to $198,799. Customs revenues showed a decline of over $500,000 and excise collections were increased by only $200,000. Post-office returns increased by $1,100,000. While there has been an increase of the revenues in July, it is already quite evident that Canada will either have to impose new taxes, reduce expenses, or borrow more heavily than heretofore.[4] In the meantime she will meet the deficit for the year 1915–16 with the proceeds of a recent sale in New York of $45,000,000 of one- and two-year notes at a rate and price to yield investors over 5 per cent.[5]

VII. METHODS OF RECONSTRUCTION

The task of Canada's Minister of Finance during the next few years will not be an enviable one. The protective tariff will probably provide less revenue than in the last two years. The excise and customs duties on liquors and tobacco are probably as high as they could be placed without actually decreasing the revenue. It

[1] *Canadian Liberal Monthly*, April, 1915.

[2] Quoted by J. J. Hughes, *Debates*, 1915, p. 1083.

[3] *Debates*, 1915, quoted, p. 870.

[4] *Toronto Globe*, August 6, 1915.

[5] *Globe*, July 24, 1915.

would not be wise to increase the issue of Dominion notes without increasing the gold reserve. Admittedly the market for governmental borrowings has an uncertain future and it would not be surprising if the Allies, including Canada, yet find it necessary to increase taxation heavily in order to bring the war to a satisfactory ending. In any case the government should not allow a continuance of a deficit on Consolidated Fund Account. The Canadian government must therefore consider either a decrease of expenditures or the imposition of new taxes.

The possibility of reducing expenditures is an interesting topic. Of course war expenditures will be maintained at the present level of $150,000,000 or more as long as the war lasts. Canada will probably borrow the interest on as well as the principal of those expenditures. She may as well face now the possibility of having to raise a part of them by taxation. Pensions will involve an annual expenditure of $2,500,000 on account of the first year, probably more and additional sums for each year that the war lasts. This is practically a new item in Canadian finance.

Expenditures on capital account are largely for public works. They have never been more than $42,593,167 (in 1909) and they have averaged $30,000,000 since 1907.[1] Most of the public works paid for in this way become productive of revenue for the Treasury or of income for the nation at large. Many of them are highly ornamental. Doubtless necessity will eliminate any expenditures of doubtful value, such as the Georgian Bay Canal, which might be charged to this account.

Expenditures on Consolidated Fund Account are not likely to be reduced. The cost of maintaining most of the government services is likely to increase with the increase in the population. The cost of collecting customs duties is not likely to decrease so long as the protective system is retained, even though the collections decline. The cost of collecting excise duties will increase if new excise duties are imposed. The cost of administration of Dominion lands is likely to decline less rapidly than the revenues derived therefrom.

[1] *Canada Year Book*, 1913, p. 517.

The government may, however, receive a greater net revenue from a few departments, especially from the post-office, and possibly from the government railways. These, however, will not be sufficient to meet its needs.

Two possibilities of reducing public expenditure remain. One is the reduction of the expenditures for public works chargeable to income. Many of these are useless concessions to constituencies which have supported whatever government happens to be in power. It is well recognized that a constituency must support the government if it is to have public funds spent within its borders, and consequently promise of public works is a bait regularly held out by retiring governments in doubtful constituencies. The sooner this type of public expenditure is abolished the better.

The other possibility is the abolition of the system of provincial subsidies, one of the most vicious outgrowths of the British North America act. Such a change would relieve the government of increasing obligations, which amounted to $11,280,468 in 1914, and would end the system which interprovincial politics disturbs every few years. It is unlikely that the system will be abolished; but this much may be said, that if the provinces are to receive increasing sums from the federal government they should not object if the federal government invades the field of direct taxation to which, according to the British North America act, the provinces are restricted.

In all probability, then, the solution of Canada's fiscal problem must be the adoption of new taxes, direct and indirect, and a complete revision of the tariff.

The revision of the tariff will probably include the imposition of a heavy duty on tea. In Canada, where tea cannot be grown and where it is consumed by all, a duty would be an ideal war tax. Duties in coffee are doubtless less productive of revenue than they might be by reason of the omission of a duty on tea from the list of revenue-producing taxes. Diamonds, until lately free of duty, should be taxed much more heavily than 7½ per cent. Whether protection will be reduced no one can tell, but the probability is that the system of protection will remain in Canada until after it has disappeared from the United States. In the long run Canada

would certainly benefit from the adoption of free trade and the diversion of capital and labor into those employments where the greatest efficiency obtains in Canada. Furthermore, a reduction of many duties which are practically prohibitive might bring greater revenue returns.

Excise duties on domestic manufactures of several kinds, which might very well be imposed without great injury to the industries, would provide a very large revenue. An excise tax on war-order products might prove the best method of taxing war profits.

By the British North America act the federal government may raise revenue from either indirect or direct taxation, but heretofore no attempt to introduce direct taxation into the federal fiscal system has been made, because the provinces are restricted to direct taxation. Another reason for refraining from the use of direct taxes is the fact that the federal government has not a taxing machinery adequate for the task. The provincial governments may, however, have to give up their subsidies from the federal Treasury or allow the federal government to impose direct taxes. As they will probably prefer to keep the subsidies, one may regard direct taxation in the form of corporation taxes, an income tax, a land or property tax, or succession duties as an almost inevitable addition to the federal fiscal system.

There is one other possible source of revenue worthy of serious consideration: namely, the application of the local assessment principle to federal finance. It has been the custom for the federal government to raise the cost, and otherwise meet the expense, of constructing many public works which benefit particular localities or particular individuals. The improvement of Toronto's harbor provides a good illustration. It is generally accepted that since Toronto is a Conservative city and sends eight Conservatives from the eight constituencies, one may expect the present federal government (Conservatives) to spend huge sums on the improvement of the harbor, and real estate interests argue that therefore the future of Toronto's real estate values is assured. If property-owners frankly confess that such an improvement will affect the price of property favorably, the suggestion that a large part of the cost of the improvements (in this case about $26,000,000) should be

assessed on the property-owners of Toronto is worth considering. One can scarcely deny the justice of the proposal or deny that such a scheme would put an end to the system of unnecessarily spending public funds in constituencies where proper support is given to the party in power or where the issue of an election is doubtful. It would have provided the revenue to defray a very large part of the increased expenditures of recent years, and might well be expected to provide large revenue in future. The tax could be charged directly on the municipality.

It is impossible in a study of this length to go into the possibilities of the financial situation of the Dominion government. It has been worth while to suggest the main lines of argument. The solution of the problem should be the work of a committee or a commission of the best financiers Canada can boast.

W. J. A. DONALD

MCMASTER UNIVERSITY
TORONTO